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STATE FOR EUR/NCE DAVID KOSTELANCIK AND MICHAEL SESSUMS
USDOC FOR 4232/ITA/MAC/EUR/JBURGESS AND MWILSON
TREASURY FOR OASIA MATTHEW GAERTNER
FRANKFURT FOR TREASURY JIM WALLAR

E.O. 12958: N/A
TAGS: EFIN ECON PREL PL
SUBJECT: Polish Economy not yet Hurt by Rising Oil Prices

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Summary

¶1. (SBU) Rapidly increasing oil prices have had a limited effect on the rate of inflation in Poland to date. Over the past 12 months, the average zloty price of oil has increased 12 percent, while the consumer price index rose only 1.3 percent and producer prices remained unchanged. Nevertheless, most analysts agree that the skyrocketing price of oil is a long-term threat to Poland's economic growth. To date, however, high unemployment, low wages, low food prices, weak domestic demand, and the strong zloty have kept inflation under control and mitigated the impact of increasing oil prices.

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Increasing Oil Prices Have Limited Effect - to Date
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¶2. (U) The price of unleaded gasoline has risen 6.9 percent since August 2004 in Zloty terms, while the price of diesel oil has climbed 15.8 percent. For Poland, which is an oil consumer rather than a producer, the most noticeable effect (aside from at the gas pump) has been the higher cost of imported materials. Higher production costs in the manufacturing sector have reduced profitability and negatively affected investment demand. So far, Polish households are continuing to purchase gasoline at the expense of some reduction in spending on other goods. Studies by the National Bank of Poland show that rising oil prices have a negative effect on demand in the short and medium term. Thus a 10-percent increase in the price of oil may lead to a 0.2 percent decrease in GDP over 6-8 quarters.

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CPI up only 0.5 percent due to low Domestic Demand
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¶3. (U) Demand shocks have an effect not only on economic activity, but also on the consumer price index (CPI). The share of fuel prices in Poland's inflation basket is 3.84 percent. Thus, the average 12 percent increase in fuel prices over the past 12 months added an extra 0.5 percentage points to the annual CPI. In contrast to this direct effect, the indirect impact of changes in energy on the prices of other goods and services is hard to estimate. In times of high consumption, increasing fuel prices are almost immediately reflected in the prices of such goods as food, shoes and refrigerators. When domestic demand is low, as is the current case in Poland, the effect is usually delayed.

4.(U) So far, the Polish National Bank reports companies have refrained from hiking prices for goods to avoid a loss in market share. The companies accept lower profits by absorbing increased production and transportation costs, expecting an increase in demand in the near future. This behavior considerably reduced the increase in the CPI in Poland during the first half of 2005. However, most analysts expect consumption to pick up in the latter half of the year, and companies are acting accordingly.

5.(SBU) Experts figure that the price of goods in Poland will start to jump significantly only after oil hits $75 per barrel. According to Marek Zuber, an economist from the Internet Brokerage House (IDM), a $100 per barrel oil price would increase the CPI by 0.5 - 0.7 percent. Most economists agree that starting in September, inflation in Poland will begin to rise, but that at year-end it will still be only around 1.8 percent, or well below the Monetary Policy Council's average inflation target of 2.5 percent. Thus, the Monetary Policy Council cannot use higher oil prices as a strong argument against further interest rate cuts.

A Drop in Russian Oil Prices would help

¶6. (U) The recent prediction by Russian Minister of Economy German Gref that the average price of Russian oil will fall to $48 per barrel by end 2005, if realized, would be good news for the Polish economy. Poland uses Russian Urals' oil and processes it into gasoline considered expensive by Polish consumers. Polish refiners are cautious about hazarding predictions of a drop in future prices. PKN Orlen and Polish Nafta experts estimate that a drop in oil prices of 10 percent translates into a few percent decrease in gasoline prices, provided that other factors - such as exchange rates - remain unchanged.

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Ministry of Finance won't budge on Excise taxes
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¶7. (U) Despite strong pressure by fuel companies and consumers to reduce excise taxes, the Ministry of Finance is not contemplating a decrease. The Finance Ministry believes market mechanisms such as the strong zloty and falling inflation are more efficient in controlling fuel prices in Poland than fiscal adjustments. It also notes that excise tax cuts often do not reduce retail gasoline prices because, in practice, they are often absorbed by fuel producers, wholesalers and retailers.

Comment

¶8. (U) To date, the impact of rising oil prices on the Polish economy has been surprisingly limited. Low domestic demand, high unemployment, low wages, and low food prices, combined with a stronger zloty have kept inflation moderate. However, many analysts now expect that the ultimate impact will take six to eight quarters to ripple through the economy. As the price per barrel of oil hits new highs, it is harder and harder to discount the likelihood that it will impose real costs on Polish companies and consumers.
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